Overcoming Hurdles in the Variable Annuity Race

By Kerry Pechter *Thu, May 11, 2017*

Prudential and AXA have remained among the perennial leaders of the variable annuity space by patiently tweaking existing products and exploiting niche opportunities.

It's well known that variable annuity sales have been in decline and issuers have no great appetite for the risks associated with lifetime income guarantees. And then there's the problem of uncertainty over the fate of the DOL fiduciary rule, which has put at least a temporary chill on sales of B-share VAs on commission to IRA rollover clients.

But the big VA sellers continue to tweak their offerings in order to make sales that gather fee-generating premia without introducing hard-to-manage risks. For instance, there's the enhanced death benefit announced last week by Prudential, the fourth-ranked individual VA seller in 2016, with sales of $7.98 billion.

In this story, we'll also talk about the success of another non-income variable annuity product, AXA's Structured Capital Strategies indexed VA. Prudential and AXA, along with Jackson National, the AIG Companies, MetLife, Ameriprise Financial, Lincoln Financial and Nationwide are all perennial leaders in the VA space, where the top 10 issuers routinely account for about 80% of the sales. (TIAA, a group variable annuity specialist, is in a category of its own. ING, now Voya, switched to indexed annuity sales.)

All of these companies, to varying degrees, relaxed the torrid VA sales paces that preceded the financial crisis and persisted until about five years ago. They have either cut back on sales of living benefit rider products, de-risked their remaining income benefits with volatility-managed funds and less generous deferral bonuses, or switched their marketing efforts to accumulation-only contracts. A few firms have offered to buy back their under-water (i.e., in the money) contracts from owners.

Prudential has consistently said that it's in the VA business to stay. It has an advantage: Its VA book-of-business may be stabler than others' because it controlled the risk of its living benefit riders by employing a form of constant-proportion-portfolio insurance. In its Highest Daily VA contracts, the allocation to bonds automatically rises when equity values go down, thus protecting each account's ability to fund its guarantee.

With the Legacy Protection Plus product, Prudential is looking to pick up some premia that aren't tied to an income rider. The Legacy Protection Plus death benefit is now available to purchasers of Prudential's popular Premier Retirement VA, which had sales of $3.2 billion in 2016. The benefit is aimed at financial advisors who do a lot of wealth preservation and estate planning work for high net worth clients.

The Legacy Protection Plus offers a 7% simple interest roll-up until the benefit base reaches 200% of the first-year purchase payments or the contract anniversary on or after the owner's 80th birthday, whichever is earlier. On the death of the contract owner, the beneficiary receives the greater of the account value or the benefit base.

The new death benefit is not available to clients who opt for the contract's living benefit riders (a Highest Daily death benefit is available to them). The current annual expense ratio is 0.65% for contract owners ages 55 and under at purchase, 0.80% for those ages 56 to 70, and 0.95% for those ages 71 or older.

"We see so much of our audience focused on the income component. But we also think there's a significant marketing opportunity among individuals who want to transfer wealth to their children or to charities, and an opportunity for us to partner with advisors who spend a lot of time on that," said Jim Mullery, head of distribution and sales for Prudential Annuities, in an interview.

A variable annuity with an enhanced death benefit gives heirs or beneficiaries protection against market risk while allowing the owner to take income (with taxable earnings out first) as needed or to postpone taxes on the gains (except for required minimum distributions starting at age 70½) by not taking withdrawals.

There are no special tax benefits to transferring money through a non-qualified variable annuity death benefit, however. Heirs can't receive the death benefit tax free, as they would the proceeds of a life insurance policy, and there's no potential "step-up in basis" that would eliminate capital gains taxes for heirs. Instead, they pay ordinary income tax on the difference between the cost basis of the contract (the purchase premia) and the death benefit.

VA Sales Leaders ($M, 2016)

Issuer	4Q2016	YE2016
Jackson National	$4,340	$17,215
TIAA-CREF	3,189	12,863
AXA Equitable	2,584	9,755
AIG	1,788	7,846
Prudential Financial	1,636	7,984
Lincoln Financial	1,477	6,588
Nationwide	1,179	4,598
Ameriprise Financial	956	3,936
AEGON/Transamerica	937	4,348
New York Life	892	2,884
MetLife	788	4,335
Thrivent Financial	764	3,048
Pacific Life	682	2,642
Allianz Life	450	2,025
Fidelity Investments	374	1,395

Source: Morningstar, Inc., 2017.

"We're looking at a whole different component of the marketplace with this enhancement," Mullery told *RIJ*. "There have definitely been some challenges in VA world in sales. The ambiguity around the Department of Labor's fiduciary rule has had an impact. But we are committed to this marketplace. We're bringing out this feature because we think it's important to innovate in this space."

The Premier Retirement variable annuity series B-share contract has a seven-year surrender schedule, an

M&E (mortality and expense risk) fee of 1.30%, a 0.15% administrative fee, and annual fund fees ranging from to 59 basis points to 1.67%.

As of the end of the third-quarter of 2016, Prudential was one of seven variable annuity issuers (including TIAA) with more than $100 billion in VA assets. Among issuers of individual VA assets, it ranked third with $154 billion. MetLife led with $166.7 billion and Jackson National was second with $154.3 billion.

The B shares of Premier Retirement variable annuity sold $3.21 billion in 2016, as the fifth top-selling individual VA for the year. Prudential finished 2016 in fourth place among individual VA sellers, with sales of $7.98 billion in 2016, down from $8.72 billion in 2015.

AXA's indexed variable annuity

When AXA introduced an indexed variable annuity in 2010, called Structured Capital Strategies, it was difficult to know what to make of it. Like fixed indexed annuities, it offered downside protection with upside caps; but it offered much higher caps than FIAs could offer because it protected the contractor owner from only the first 10% to 30% of the loss in a down year, rather than from 100% of a loss. One, three and five-year terms, as well as several index options, were made available.

At the end of 2011, the contract was ranked 42nd among VA contracts with sales of $747 million, according to Morningstar. Then SCS started to climb the chart—in part because the sales of so many other contracts were falling and in part because advisors were gradually warming up to it. Sales were $1.4 billion in 2012 (17th) and $1.54 billion in 2013 (20th).

In 2014, sales slipped to $972 million, for a 35th place finish. But SCS bounced back in 2015, selling $1.45 billion (14th place). In 2016, it was the second-ranked individual VA contract in the fourth quarter ($947 million), and the seventh-best seller for the year ($2.62 billion). (Jackson National's Perspective II 7-year contract was the runaway leader in 2016, with sales of $11.83 billion.

"After we started that category, it took a while to get firms to say yes, and then they started to say that it made a lot of sense. Now there are three or four companies selling indexed variable annuities, and probably more coming in. By adopting these strategies, our competitors validated the space," said Kevin Kennedy, Managing Director and Head of Individual Annuities for AXA in the US. MetLife and Allianz Life are also issuers of indexed variable annuities.

"It's been a good couple of years," he added. "We just crossed 100,000 contracts and $10 billion in sales in Structured Capital Strategies. We continue to innovate it. Last year we added an annual lock, which means you can buy an S&P index-linked product and get a 10% cap every year for five years and downside protection of up to 10%. It's not a 'Trust me' indexed product where you get a good rate at the start but you don't know what it will be in the future. You know what you'll get from point to point every year.

"With a lifetime income benefit, you're marrying the insurance company. With a B-share like ours, you get to 'date' the insurance company. This is not a 'buy and die' relationship. You're not committing to us forever. You evaluate your options at the end of five years. We think people will look at the SCS and think, ‘It’s been a great run in the market, but gravity will set in at some point. With this product I’ll be getting some upside potential and some protection.’”

© 2017 RIJ Publishing LLC. All rights reserved.